JOINT BOARD EN BANC HEARING

Wednesday, November 17, 2004

Panel 1

Good afternoon. I want to thank the members of the Joint Board for putting this Hearing together, and allowing me to participate on this Panel. Before I address the questions asked of this Panel, I'd like to put the issues of this proceeding into the appropriate perspective.

In anticipation of the end on June 30, 2006 of the "interim plan" adopted in the *Rural Task Force Order*, the Commission asked the Joint Board to undertake a review of what measures should succeed the RTF plan and how rural and non-rural high-cost support mechanisms should function together, the so-called "harmonization" of rural and non-rural support. Specifically, this Panel has been asked to comment on the cost standard for measuring rural carrier support, and whether the standard should be forward-looking economic costs as is the case with non-rural support, or whether it should continue to be based on embedded costs.

But before limited resources are expended on this effort, there is another kind of harmonization that *urgently* requires the Commission's attention. I speak, obviously, of the critical need to harmonize the disparate rules under which carriers compensate each other for terminating each other's traffic. The patchwork of different intercarrier compensation schemes, resulting from legacy regulatory classifications such as "local", “toll”, “EAS”, “CMRS”, “enhanced”, “interstate”, “intrastate”, “interLATA”,”intraLATA”, “intraMTA”, *etc*., is fundamentally broken.

Moreover, the sustainability of universal service is jeopardized by the continued reliance on implicit support contained in both retail and intercarrier rates. For example, implicit support for universal service from interstate access is eroding as customers shift from traditional wireline long distance to wireless “one rate” plans and VoIP. Indeed, over the last four years, the interstate access minutes of the largest ILECs have fallen by more than 25 percent. Intrastate access minutes have probably fallen by a similar amount. Even the federal Universal Service Fund, although explicit, relies on an unstable funding base due to the same legacy regulatory classifications. The regulatory distinctions between “interstate” and “intrastate” services, and between “telecommunications services” and “information services” have become increasingly blurred with the proliferation of various service bundles. As a result, the federal USF assessment base is declining as customers shift to carriers and services that minimize contributions to USF.

As you are aware, ICF has proposed a *comprehensive* plan to move intercarrier compensation regulation and universal service from upheaval to stability. The plan will eliminate today’s multiple rate structures for intercarrier compensation, and replace them with a single unified rate structure. As for universal service, the plan eliminates implicit support from access rates and replaces today’s revenue-based USF contribution mechanism with a hybrid telephone number-/connection-based mechanism.

First, ICF is a carefully balanced plan, not favoring any particular industry segment. For example, the plan creates two new explicit support mechanisms, one for non-rural carriers and one for rural carriers, recognizing the cost and competitive differences between these entities. Second, the plan is comprehensive, addressing approximately $10 B of intercarrier compensation revenues, compared with the less than $1.2 B of High Cost Loop Support support. Finally, the plan reforms the federal USF contribution mechanism, which is essential, especially if the outcome of this preceding were to result in increases in rural high-cost support. I believe that these problems need to be fixed before spending resources to modify the existing High Cost programs.

Moreover, the ICF addresses many of the questions being asked of this and the other Panel. For example, the Plan calls for the continued calculation of ILEC support (other than IAS and HCM Support) to be based on ILEC embedded costs. Competitive ETCs will initially receive the same amount of support per eligible line as the ILEC, and remain unaffected by reductions in ILEC demand. Thereafter, the Competitive ETC’s per line support will increase or decrease in the same proportion as the applicable ILEC revenue requirement. With regard to sales of exchanges, the Safety Valve for High Cost Loop Support is modified to enable the buyer to be eligible for Safety Valve Support immediately following the acquisition of rural exchanges. High Cost Loop Support is further modified with the elimination of the nationwide indexed cap, the unfreezing of the National Average Unseparated Loop Cost Per Working Loop, and the elimination of the different support percentages based on study area size. While ICF does not specifically address the study area versus statewide averaging question or changes to the definition of Rural Telephone Company, surely the landscape will be significantly altered by ICF.

Another reason to tread slowly in this proceeding is that it is so highly dependent upon the outcome of the current *ETC Designation* docket. Let me explain why. The Joint Board, and this Panel, have been asked to recommend the cost standard for determining rural carrier support. The selection of the cost standard, whether it be forward-looking or embedded, is important for determining *portable* per-line support between ETCs. AT&T has strongly advocated, and the Commission has agreed, that forward-looking costs are the most competitively neutral measure of portable support. First, forward-looking costs are technology neutral, reflecting the latest and most efficient technology required to provide universal service. Second, forward-looking costs are not beholden to any particular carrier's costs of providing universal service, whether it be that of the incumbent or the competitive ETC. Yet, the record is overwhelming with criticisms of forward-looking costs, and the Synthesis Model in particular, with respect to its ability to adequately capture the wide disparity in rural study area costs. That is the crux of this investigation.

I, on the other hand, ask a different question. What if high-cost support were *not* portable? What if multiple ETCs in some rural study areas were determined *not* to be in the public interest? Then, for those study areas, it would not be necessary to replace the current embedded cost standard with one based on forward-looking costs. Why? Because the support would *not be portable*. In the *ETC Designation* proceeding, AT&T

advocated the establishment of a benchmark of high-cost support per line, above which there would be a rebuttable presumption that a study area served by a rate-of-return regulated incumbent LEC will be limited to one ETC. For those study areas with per-line support above the benchmark, the support would be *de facto* not portable. Thus, there is no need to replace the cost standard in those study areas.

Certainly, this proceeding should wait for a Commission ruling in the *ETC Designation* docket, if for no other reason than to find out where deployment of resources to measure forward-looking costs are truly necessary.

In sum, I believe the Joint Board should proceed very cautiously with this investigation, and should certainly not require the devotion of resources, whether they be state or federal regulatory or industry resources, prior to implementation of the ICF plan and Commission order on the *ETC Designation* docket.

Thank you and I'll be glad to answer your questions.